CHAPTER 1

Intellect, Instinct, and Guts

Understanding the Psychological Profile

At the age of 30, Charles Luckman was named president of the Pepsodent toothpaste company and later became president of Lever Brothers. Luckman knew from the age of nine that he wanted to be an architect but went into sales after graduating from the University of Illinois. Despite his great success in business, he eventually resigned from Lever Brothers to take up his architectural dream. From that point forward, he helped design such architectural wonders as the CBS Television City Center in Boston, the new Madison Square Garden in New York City and the NASA Manned Spacecraft Center in Houston. So, how did this businessman and architect who was once known as the "Boy Wonder of American Business" define *success*? "Success," Luckman said, "is that old ABC—ability, breaks, and courage."

Luckman's life was a remarkable demonstration of an amazingly simple yet complex formula for success, something that I have been searching for in my work with traders. For many years now, I have been trying to define the key ingredients of successful traders and portfolio managers (PMs) by exploring a range of personality strengths and weaknesses among them. To do this, I have asked such questions as:

- What are some of the different combinations of traits that contribute to individual success stories?
- How much "talent" is inborn, and what can be learned?

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- How can hedge fund managers recognize talent and capitalize on it?
- Can talent be developed in individuals who are lacking natural ability?
- What are the developmental challenges that individuals must overcome if they are to develop into world-class performers?
- What attributes may look beneficial in the hiring process but then prove to be obstacles to success?
- Ultimately, what is the ideal configuration of intellect, instinct, and guts that, when blended, create the highest performers?

Along these lines, I was fortunate to talk to one of the premier hedge fund managers on Wall Street. During our interview, we discussed his views on the qualities that he believes make for the most successful analysts and portfolio managers in the business. This is what he had to say:

Kiev: What are the basic principles of trading success?

P: These are the principles that I put on the wall once I gave them that mythical line of credit. My number-one is to know names. I think there are a couple of ways to make mistakes. One is to fall in love with the concept or thesis before you know the name. We will live or die based on whether we know the names better than anybody else on the street.

K: Is that the variant perception?

P: It may not be variant; it may be reinforcing. I am on top of consensus on a couple of my longs, but I don't care because we are right. The market will have a lot of volatility. Some of that will be rational, and some of that will be stock prices leading you. Other than that, it will just be volatility. The reason the stock is down is because somebody else at a different organization is making a decision based on that person's viewpoint. It may have nothing to do with this stock. That's the dip that we are going to buy, and we are now going to fight this guy. He is selling; we are buying. How are we going to win that game? We are going to win that game if we know our names better.

K: How do you know it better?

P: You never really know you know it better, but we can tell whether we know our names holistically or whether we know our names intuitively. We can judge it relative to other names we know in our portfolio.

K: What do you mean *holistically* versus *intuitively*?

P: You have done all the work and you know the balance sheet, not only the numbers but also the business and how it works and the regulatory environment and the big changes in the business—not just a narrow subsegment.

Some of the analysts we had that didn't succeed here, that we had to let go, when we asked them to look at a name they would write the bull points and the bear points, all the obvious stuff. Then they would say, "I will buy a one percent position," or "I will short a one percent position," or "I would do nothing."

A pure listing of the bull points and the bear points is just a simulation. They are simulating that which Wall Street has told them or assimilating that which the company has told them. They are putting all the facts down on a page. They don't know that name. They have summarized the Cliff Notes from that name.

I would say that in eighty-five percent of investment organizations that's as far as they go. To know the name holistically is to do the other fifteen percent. So, when news comes out in which we have the best framework to interpret that news and make decisions as to whether this is nonsense or meaningful, whether this is underreaction or overreaction and how to move our portfolio, it all starts with, do we know our names? Do we know the industry?

Number two would be consistency. I need to remember this one as well. Sometimes we go into something saying, "We think for the next three years this company is structurally challenged. They are out of favor. Over the next three years, the company will not be able to perform. They cannot compound value. The stock is overvalued. Therefore, we think the stock is going to be down over forty percent over the next three years. It's just a question of when, and we want to short this stock." If we decided that's the case, then we need to be consistent. If they have a good quarter, who cares? There is a time over a thirty-six-month period when there is going to be a couple of good months. Who cares? There are going to be times when we aren't as long. There are going to be a couple of bad months. We cannot react to the twenty-five percent of data points that are good knowing that we have evaluated the landscape and that we know that seventy-five percent of the data points are going to be bad over time. That is a virtual certainty.

Number one, know your names. Number two, be consistent. Number three, ask yourself if your dollars have reflected your latest thinking.

K: Level of conviction?

P: I think a lot of times as the stock goes up, people like to have a bigger position because it's a happy name. If a stock has gone from thirty-two to thirty-eight dollars, on the one hand it's great, and you feel great about that name. But should you have twenty more dollars in that name today at thirty-eight? What really changed between point A and point B? Your story can get twenty percent better or in fact more than twenty percent better, but should it have more dollars allocated to that name at thirty-eight than you do at thirty-two? I think it's like comfort foods. We all know that if we eat comfort food, we get fat, and it's bad for us. Sometimes people just want to have it. It's the irrational, but they want to have it. Holding onto a winner without selling is like comfort food. People need to be willing to let go.

Number four would be "no opportunity equals zero cost." I think that some people get it in their minds that if they look at a stock and decide not to do anything and it goes up a hundred percent, then it cost them something. It cost them zero. They're not any poorer.

K: As opposed to beating themselves for missing it?

P: I think people are allocating capital in names because they think there is a possibility that this is a big stock, and they just don't want to miss it. So, they allocated a little more capital to the position. There is an instinct that we have to do a little more. They are afraid of the opportunity cost. So, those are my four cardinal rules.

K: How much are these rules rooted in fundamentals?

P: We are blessed and burdened with being rooted in the fundamentals. We are blessed with it because ultimately it helps us. We are burdened with it because it gives us conviction at times that may give us a sense of overconfidence. It's so tangible. We can all say tangibly the stock trading at six times earnings is cheap, but if other people are making decisions about less tangible things we will be blind to it.

K: What else would you teach a new analyst/PM?

P: When a guy comes in as an analyst, we teach him other things. We teach him how to communicate, how to stand up in the names, financial analysis, business analysis, how to do proprietary research and develop sources. This is what I would say to the guy: "You have graduated. Now you have your own pad. Here are the four cardinal rules. Before you make a capital allocation decision, I want you to go through this checklist."

K: You have guys that are smart analysts, that are the best of the best, and you think it's time to give them a portfolio. How would you assess whether a guy has what it takes to run a portfolio? How would you differentiate? Is there a decision-making gene, a risk-taking gene? A risk management gene, as opposed to just an analytic gene?

P: We critically refer to it as head, heart, and balls. You have got to have all three.

K: What does the PM have that the analyst doesn't have?

P: The analyst can only have a head and be a good analyst.

K: The PM has to have the heart and balls. Would you asses that from a guy's life experience? He played football or was a Navy Seal?

P: I think people who are leaders, entrepreneurs, are competitive, athletically or otherwise. I think that all those things can tell you something about that. Also, somebody can have a perfect resume, you know, undergraduate at Yale, went to McKinsey, did a Harvard MBA, went to Goldman Sachs. I look at it and say, "The guy has never taken a risk in his life. This guy wants to be the middle-of-the-road guy. He is proficient. He would be a great manager. He may even be a great analyst, but it's totally unproven as to whether he is a risk taker and a risk manager."

K: Could he be taught that, or is it genetics or DNA? Would you take that Goldman Sachs guy?

P: I am not sure if you start learning it at thirty-four years old—it may be starting too late. You can teach an adult to ice skate, but it's a lot easier to teach a five-year-old. He is going to be a better, more natural skater over time.

I don't think that I was born with a risk gene. I think I learned risk management because I started gambling on horses and making probability bets when I was a kid. I think I was competitive because I was playing hockey, and that just became my nature. I think that those were all learned responses. I wasn't born with those. They were learned from the time I was young.

Can you teach somebody who has come through one path for forty years to take a different turn? I don't know. I don't think so. I can tell on that organization chart that we have some guys who are phenomenally good. For example, one analyst is the proverbial example I gave you. He is a Yale undergraduate. He went to Merrill Lynch investment banking, and then he came here. He succeeded in everything he did. He had a four-point-oh GPA. You give him a complex problem, he goes away. He comes back, and he knows everything. I don't want to glass-ceiling him, but I have no idea if he will ever be a good trader or a good risk manger. I have an enormous amount of confidence that he is going to be a terrific analyst. So, I view him as someday a director of research but not a portfolio manager.

K: Could you pick someone who you would say could become a portfolio manager?

P: Yeah, Brandon.

K: What does he have that is different from the Yale grad?

P: They both have an emotional balance. They are true to themselves, and they are centered. They are consistent. They are self-confident. They have a framework. They are incredibly detail-oriented. You know a lot of people look at the pieces of the puzzle and see what's there. You also need to see what's *not* there and what's missing. I think they have great vision and have great ears. I think they are self-competent. It's hard to figure out what the differential skills are. It may just simply be a practicality about them. I think that a great analyst is prone to be over-theoretical. Whereas I think a great portfolio manager is immensely practical. It's not about whether it's fair or unfair that the stock goes up or down based on the fundamentally technical or other reasons. They look at it practically.

My job is to make investment decisions that are going to be profitable. I think that an analyst is prone to believe in hindsight that the market made a mistake and he didn't. Whereas I think a portfolio manager is inclined to look at the situation and say, "What can I draw upon to improve?" In terms of pattern recognition, you need to go back and figure out what the pattern was that you should have seen.

K: Which the analyst may be reluctant to do.

P: The analyst may be more narrow-minded in his thinking and just become exasperated. He may think, "I have hit every earnings estimate that I have ever had. Why am I not making money?"

K: So, what if you have a guy with an incredible resume? What does he need beyond the resume that can be picked up in an interview and review of his history?

P: He can be an idealist. He has to be comfortable and define his job, not from an intellectual perspective, but from a practical perspective. He would need to understand that everything is seated at the table.

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What are the basic principles of success? Are there specific genes that make success easier for some than for others? Are some people cut out for some positions for which others are not? Can principles of success, like those outlined earlier, be learned or forced? These were the questions that were discussed. The answers are worth considering when evaluating anyone for employment in a hedge fund as an analyst or portfolio manager. But the answers aren't cut and dry.

The measure of someone's potential success can perhaps never be completely known, but a lot can be discovered through a careful review of psychological tests, personal history, and intense interviews in which the individual's life experiences, past professional experiences, and ways of dealing with risk, stress, life events, success, and failure can be evaluated in order to determine a person's characteristic ways of functioning in the world.

A *psychological profile* can be created in various ways, using standardized psychological tests, interviews, reference checks, and the like. Whatever tests you use, it is important that you consider certain dimensions of behavior I believe are critical to a trader's edge. These include how well a trader:

- Makes decisions
- Generates ideas
- Handles adversity
- Manages himself and others
- Sets and works toward goals
- Conceptualizes and engages in abstract reasoning
- Personally engages in action in his approach to work
- Solves problems and makes decisions
- Generates creative ideas about the instruments and companies being traded
- Takes risk in an appropriate way
- Leads and empowers others in pursuit of stretch goals and targets

You also want to evaluate how an individual handles research projects you give him to assess the quality of his work, his diligence, his ability to think creatively, and his sense of urgency and thoroughness. How receptive is he to criticism? How original is his thought process? Take your time here and do not rush to judgment. This real-time evaluation will give you more color on how he is likely to adapt to your team than what you might glean

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from the interview process. Such a comprehensive review can be used to assess an individual and make probabilistic predictions as to how he is likely to behave in the future in the context of the risk-taking required for working in a hedge fund or financial institution.

By exploring these themes, I have been able to increase my ability to determine whether a candidate has the requisite personality that will succeed in this business or in a particular facet of this business. These characteristics also provide a template for reviewing the performance of existing portfolio managers, as well as hedge fund managers who are trying to take their performance to the next level.

A HISTORY OF SUCCESS

The fundamentals of education and work experience are just a beginning. In order to develop a true psychological profile and determine whether a candidate has the trader's edge, you must consider his history of success. What is a history of success? As cliché as it may sound, you will know a history of success when you hear it. Success manifests itself in a number of ways. For example, it could be the story of a young Russian immigrant with one year of high school who arrived in the states and one year later received a full scholarship to a pre–Ivy League prep school, followed by a magna cum laude degree from an Ivy League college, making his way to M&A at a major investment bank and eventually trading convertible bonds at a $1 billion hedge fund. But success can also be found in the candidate who was a Rhodes scholarship winner and played on his country's Davis team representing his country in international competition. Basically, a history of success connotes drive, goal-directedness, conscientiousness, and discipline.

Of course, you can also gain a lot of information from reference checks. I want to know how good a candidate is relative to all the people with whom the reference has worked. I am looking for superlative assessments that sound like the following report on Richard, given by a senior portfolio manager who had worked with him at his previous position:

> *Richard was a "tremendous hire" and a "perfect candidate" and he could not recommend him more strongly. He described Richard as "smart, talented, thoughtful, methodical" and, importantly, a good*

guy and someone with whom he enjoyed working. He claimed that Richard is among the top 2% of people he has ever trained given how quickly he got up to speed and the quality of the questions and thoughtfulness of his remarks. He believes Richard's prospects and future are unlimited. "Richard knows a lot, is humble about what he doesn't know, understands risks, understands the markets, deals well with disappointment and has a ton of common sense. He will be an immediately impactful portfolio manager."

I recommend talking to several people about a candidate and trying to size him up relative to his peers as well as sizing up the person giving the reference, how well he understands what you are looking for, and how broad his base is in making positive statements about a candidate. The more focused your questions, based on any kind of apparent contradictions or problems that may have surfaced in the course of your enquiry, the more valuable the reference call can be in sizing up an individual's will power and desire for success, which are intangible but critical ingredients of success in a high-tension, high-risk financial trading environment.

THE ABILITY TO TAKE RISK

In the hedge fund universe, one's ability to take risk is essential. In effect, you must be able to assess the individual's capacity to function in terms of outsized performance targets, his ability to listen, and his ability to incorporate and process critical feedback about his performance by reviewing risk statistics with the risk manager so as to find ways of changing his trading and portfolio management behavior in order to improve his overall performance. The individual's past history can provide a clue as to how he is going to handle decision making in situations where he has insufficient information, how well he will be able to build a team, and how he is going to manage toward greater performance. If an individual is too cautious or too thorough, or in a psychological sense too perfectionistic, he is likely to have difficulty in adapting to a goal-oriented, high-performance approach to portfolio management and as such might not be a good candidate. In addition, it is important to screen out traders who are too impulsive, impatient, and perhaps irrational risk-takers and lack sufficient cautiousness and thoroughness to keep from blowing up.

By looking at a trader's profitability, or P&L, his percentage of winning trades, his slugging ratio or W/L ratio, as well as his Sharpe ratio and other risk statistics from his previous job, it is possible to identify certain behavioral patterns that are reflective of his overall past performance (i.e., whether he doesn't take enough risk, takes too much, is not balanced, doesn't cull his losers, doesn't get bigger in his winners—a lot of which is secondary to underlying psychological patterns). Given this information, you can make certain assumptions about his future performance.

Of course, the successful trader in essence is a goal-oriented risk-taker with good abstract reasoning and not too much cautiousness or thoroughness that might interfere with his ability to trade stocks in his portfolio, unless he is a long-term value investor. In that case, his cautiousness and thoroughness may support the kind of portfolio strategy he has developed to do very thorough work, to buy stocks when they are cheap, and to hold them for long periods of time as they mature in value.

CREATIVITY AND ORIGINALITY

Most of us are driven more by consensus than by thinking outside the box. In order to make money in the markets, a trader needs to know something that others don't know yet. So, when you are considering a candidate's potential, you must think about his thought processes.

- Does he have the ability to think abstractly and creatively and to make predictions based on imperfect and incomplete information?
- Can he function in the realm of the variant perception, where he sees nonconsensus, nonlinear, and creative investment opportunities?
- Does he have a high tolerance for ambiguity and uncertainty and a willingness to dig in deeply to understand more about a company and its product cycles, or margin expansions, or management changes or other drivers of value, than anyone else in the world?
- Is he comfortable with nonconsensus viewpoints?
- Does he take pride in his ability to function quite independently of the herd?

The ability to do this is clearly helped by the quality of work done to support investment efforts. When a trader has a high degree of abstract reasoning ability and the ability to think creatively, he is more likely to generate original investment ideas at a sufficient velocity to keep pace with allocated capital and stretch targets.

The successful trader should also be able to troubleshoot and solve problems in his area of expertise. Ideally, he should be decisive, especially when there is limited information to make an investment decision or to take calculated risks. He should be able to assess complex situations, identify the drivers influencing transformative events in companies or other variables that may influence the stock price of companies he is buying, and be able to determine the appropriate answers when there are a range of possible solutions to a given problem. He should be flexible and adaptable based on the arrival of new information and not become fixed in a position because of previous analyses. This should give him a variety of ways to handle situations.

To the extent that the trader has good abstract reasoning ability and is conceptually oriented, he should be able to adapt to a variety of situations and come up with original solutions. Most of all, he needs to be able to function with limited information and to deal with the unforeseen events in the future without guarantees or certainty. He should be comfortable with dealing with improbable events or the tails of events rather than having to rely on the consensus or conventional ways of approaching problems. Having a variant perception and doing the work to support it is a key to success.

SELF-AWARENESS, SELF-CONTROL, AND RESILIENCE

Emotional obstacles such as anxiety and fear are compounded in the daily world of trading because of the uncertainty of the markets. A successful trader therefore needs to be able to notice and separate his emotional responses from the decisions that he is making. He should be able to reach a centered state where he is able to see the movement of the market without becoming reactive to it.

Many people trick themselves into believing false notions about themselves and their abilities. Because of a lack of information or an inability to correctly assess the information they have, they either overvalue their abilities—thinking they are far better at certain tasks than they really are—or undervalue their potential—falling prey to insecurities and poor self-esteem. This is demonstrated very dramatically when I sit down with the risk manager to review a trader's risk statistics and discover how much the trader is in denial about his actual trading performance.

To combat this kind of denial, use trading statistics to provide a snapshot of the underlying behavioral dynamics of the trader's trading patterns, the capacity of the trader to handle and recover from failure, and the ability to turn breakdowns into breakthroughs. The tolerance for failure and the capacity to recover from failure and adversity are major characteristics of the successful trader since most PMs are right only 60 percent of the time and as such must be able to continue to function even though they may be wrong 40 percent of the time. This provides value in exploring thoroughly the individual's past experience with success, and evidence in his life of stretching, going for the gold, and seeking to win over adversity.

A successful trader also has the ability to function on his own, to find and develop ideas, to find sources of support within a firm or in the sell-side community, and to stay disciplined and on target. He generally prefers to function with some degree of independence and autonomy and as such functions best in environments that give him some latitude in making investment decisions. At the same time, he is aware of the need for some structure and is not so independent that he cannot function within the boundaries of good risk management principles or whatever other guidelines are provided and expected by the firm. The best PM will have a well-developed balance between his sense of urgency to get things done and achieve his goals and the need to do this in a balanced way so that he does not make mistakes because of haste or over-enthusiasm. This kind of PM is a responsible and conscientious individual who is thorough and accurate in the way he approaches his tasks, although at times he may require some support from others to help set priorities.

Teaching Traders Self-Assessment and Self-Control

Not every trader instinctively knows how to monitor his emotions. In fact, you may find this ability to be one of the hardest to discover among potential candidates. Fortunately, it is one that can be taught.

First, encourage traders to keep a log of their trades. They should record exactly what took place in a given trade and how they responded to it. For example, say they bought a stock at 20. They planned to do a

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little more work to take a larger position, but it started to move against them. By logging their emotions as well as the physical manifestations of the trade, they can review exactly what they were experiencing. They can consider how they were feeling and how those feelings affected their reactions. Did they get out at the appropriate time? Did they hang on in false hope? Was their decision an emotional one, or was it based on data?

By keeping track of this during trading and later reviewing the trades, they will become more aware of how emotional responses influence their trading. By developing a consciousness about these responses, they will be more likely to observe the repetitiveness of their actions and not act impulsively.

TEAMWORK AND LEADERSHIP

To the extent that he is building a portfolio and increasing the amount of capital in his portfolio, the successful trader will also be someone who shows evidence of leadership ability, especially when it comes time to expand his team of analysts to assist him in finding more ideas and doing more work on those in his portfolio. To be a good team leader he ideally will have the right amount of empathy required to understand the needs of those he is managing and a capacity for gregariousness and sociability that will enable him to interact successfully with others and to empower them to become all they are capable of becoming. To some extent, this capacity also relates to the PM's ability to be coached himself and to work on improving his own game by learning from others, by being flexible and accommodative to the needs and vision of the organization.

The best PMs have a capacity for leadership and teamwork that is evidenced by their ability to suppress their egos and empower others. They are less egocentric and more empathetic and empowering of others.

While a successful PM may be making investment decisions on his own within the risk management parameters of his firm, he may be called on to function with others in a collaborative way, sharing ideas and best practices, empowering others, and accepting coaching as it relates to his own performance. The introspective, highly intellectual but withdrawn or reticent individual may be a brilliant contributor but may not function as well in certain environments that encourage interaction with others. It is important that the PM have the ability to establish rapport with others and build

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relationships on the job. He ought to be receptive to feedback from those around him and willing to listen and consider different viewpoints. Does he want to be liked and respected? Does he appreciate thanks for his efforts, or does he function so independently that it is hard to envision him as contributing to a team effort?

How does he view the intentions of others? Is he a bit skeptical about their intentions? Does he question their motives? Does it take a long time for him to trust other people? How willing is he to give people the benefit of the doubt? These are critical variables that need to be considered and that can be garnered from the individual's past history and reference checks.

To the extent that the successful trader is someone who ultimately may need to size his portfolio to handle more capital and to build a team of analysts to increase the velocity of ideas, it is desirable that he has some leadership potential as well. To what extent does this PM have the self-assurance, persuasive drive, and assertiveness to overcome resistance and gain support for his vision? How resilient is he in handling resistance, rejection, or negative feedback so that he can stay focused on his goals without going into default negativity or excessive aggressiveness? How well can he handle conflict, and to what extent does he need to dominate the direction of events? Does change create problems for him? How good is he at issuing directives and motivating people to act in terms of his objectives and plans? How much empathy does he have? How able is he to understand where people are coming from and how best to incorporate their views into his directives and efforts to empower them?

Such behaviors require an ability to stand outside oneself and one's concerns about image in order to function in terms of larger objectives. Whereas an introvert may be able to look at companies and manage a portfolio, he might lack the people skills necessary to develop levels of empathy and sociability to be able to engage others and to want to lead them. Such a person may have trouble being able to scale and manage a team of analysts.

Finally, how do all these characteristics combine to make for effective leadership, balancing urgency for results with the need to involve others in a proactive and supportive way? To what extent does the candidate apply his own high standards not only to himself but to others, and is this productive or counterproductive? How much effort must he make to reconcile or balance his own needs with the needs of his team? Can he motivate others without being too critical or overpowering? The strong leader needs to be able to temper his own objectives with the need to provide enough freedom for his colleagues to be able to develop their own abilities.

PUTTING IT ALL TOGETHER

Obviously the assessment of the ingredients of a successful portfolio manager takes into consideration a variety of characteristics. The more you consider this range of qualities in evaluating potential candidates for your firm and in assessing the ongoing performance of those already working for you, the more conversant you will become with these critical psychological dimensions of evaluating human beings both in advance and during the time they are working with you in your firm. The more practice you have, the better you will get at sizing up how these differing characteristics actually manifest themselves in individuals, and how some blend and others neutralize the impact of certain characteristics. Over time, you will develop greater sensitivity about the kinds of things that make for stellar performance, which ones are stubbornly retained, which ones can be molded by training, and which ones work best in your particular organization. This is not meant to be the Holy Grail, but it does provide a larger conceptual framework for evaluating people so that eventually you are able to hire the right kind of people who will thrive in your organization.

CASE STUDY ON FINDING THE RIGHT CANDIDATE

Let's put all of this into action and consider candidates for an imaginary position. For example, imagine you are trying to find the ideal candidate for a portfolio manager's position.

Job Requirements

This job requires the candidate to provide in-depth fundamental analysis within his industry sector. He will develop financial models to predict company performance, assess event drivers within the sector, stay current with a range of sector companies to anticipate market moves, and be able to act appropriately in building a portfolio, sizing positions commensurate with his level of conviction and consistent with stretch targets that will be developed in conversation with the risk management team. He will work in a thorough manner, generate conclusions, and present findings with conviction. Then he must be able to populate a balanced portfolio in line with his varying levels of conviction. He should also use a proactive, instinctive approach to identify investment opportunities.

In addition, he will develop a detailed research and investment analysis process using proprietary financial models, valuation, and edge/outcome analysis as part of a streamlined approach to investment. He should be able to manage a team of research professionals and help direct the team into investment areas on which to focus. His research process should be a rigorous bottom's-up research and analysis of industries and companies to provide buy/sell/hold recommendations. He should also be able to create a portfolio and follow appropriate risk management techniques within the firm's investment framework. Having looked at a large number of portfolio managers, some successful and some not so successful, I would say that based on the above listed considerations, the best candidate would have:

- An outstanding academic pedigree and professional history of success
- Outstanding abstract reasoning ability and the ability to think creatively and originally
- A natural capacity for risk-taking
- A self-starter personality with drive, ego strength, and resilience
- Interpersonal skills, which make for leadership and team play
- A coachable personality

Additionally, I would look for an individual with some in-depth knowledge of the drivers of businesses, a capacity to do basic fundamental analytical work, and a passion and drive to learn about the long/short public markets. To the extent that an individual from the private equity world might have no experience trading in the public equity space, I would be interested in whether the individual has had any experience trading a personal account, although this is a secondary consideration when the rest of the pedigree and history is outstanding.

Potential Candidates

We have three potential candidates: Dennis, Peter, and Toby. Let's get to know each one and determine which is the best fit for this position.

Dennis Dennis is a smart guy. He is a very focused and determined individual who requires little guidance and attention to accomplish the task at hand. He is very deliberate and conscientious but will only assume risk that is calculated. Once he has done the necessary work and analysis, he will confidently state his opinion and will be objective in his recommendations. He sets high standards for himself and likes to chart his own course and do his own thing.

As such, Dennis is not motivated by engaging with others, supporting others, or operating as a member of a team. He is distrustful of other traders' work and contributions and prefers to operate independently and contribute autonomously to an effort. He is neither sociable nor particularly gregarious and does not value developing and training others.

Peter Based on our assessment of Peter on a number of occasions, our own interview with him, repeated phone conversations, a review of his work experience, a personality profile, and due diligence with people who worked for him and with him, and for whom he worked, it has been our impression that he is an engaging, ambitious, self-aware, self-starter who is a measured and thorough risk-taker with an extremely high level of abstract reasoning ability (both in terms of doing math in his head and solving abstract problems). He is very curious, analytical, ambitious, and competitive. He has an in-depth knowledge of the space in which he worked for ten years and high leadership potential. He has both short and long-term objectives, including the ability to integrate very complex concepts and a variety of financial instruments, such that once he learns the long/short public equity markets he will be able to leverage his private equity experience and add considerable value to his own portfolio management activities as well as those of the firm. Despite his lack of experience in the public markets, Peter has an enormous amount of self-awareness and the humility to understand the work it will take to get up to speed so that he is functioning as brilliantly in long/short public equity portfolio management as he has functioned in the private equity space from which he came.

While there would clearly be a learning curve for Peter in terms of understanding how to trade publically traded stocks, his previous success indicates that he will learn quickly. He is eager to learn, open to different interpretations, and enjoys seeking out the information and knowledge necessary to build the required skill set.

His primary reference, Dale, could not speak to his risk tolerance per se but equated *risk tolerance* with Peter's tendency to think outside the box and propose a variant view on companies. Dale, who worked very closely with Peter at his previous firm, indicated that Peter did not need to follow the pack in terms of his recommendations and instead looked at every investment decision with a fresh lens and his own process. He also mentioned that Peter has grown into a deeper maturity regarding his investment approach and in his reactions to and tolerance for mistakes. Dale said that early on in Peter's career, Peter had an aversion to discussing or revisiting names that had failed him, that he would essentially "bury his head and pretend it [the loss] wasn't happening." However, Peter has since developed an ability to learn from his mistakes and "over time has learned to examine these situations very closely, conduct a forensic-type analysis of the mistakes to better understand what went wrong, where his thinking was off, where in the life cycle of the idea he miscalculated, and determine areas where he could improve and learn. This has made him a wiser, more confident, more flexible and adaptive investor."

Toby Toby is a very smart analyst and assistant portfolio manager in a large hedge fund. He worked there for ten years and developed a lot of knowledge in international technology stocks. In fact, he generated buy-and-sell ideas for many overseas companies in which his fund currently has a couple of billion-dollar investments. For the past several years, Toby has been responsible for the portfolio management of the technology portion of an overseas fund that has produced annualized returns of more than 35 percent. During this time, fund assets have grown from $3 billion to $11 billion. He has experience in developing elaborate company models and in planning for and meeting with CEOs of companies.

He is an extremely bright magna cum laude graduate of Dartmouth, a very pleasant fellow, albeit a bit nervous and socially awkward. He has limited experience in managing others but has taught classes at Dartmouth and managed a few people while at a consulting firm.

After meeting with him, we found that, although very bright and knowledgeable, Toby had a long-term time horizon and might take some time learning to short and to assess companies for shorter-term catalysts and the path to getting paid. Although Toby knew his sector well, he tended to focus more on the big picture (one to two years out) than he would need to in a shorter time horizon, long/short, public equity–oriented hedge fund. Whereas he knew what he owned extremely well in terms of what they do and what the drivers of the stocks are, it would be a big adjustment for Toby to short stocks, something he had never really done in the mutual fund world. Previous experience indicates that it sometimes takes as much as two to three years for people to make this adjustment. Toby might also find it to be a big adjustment in managing his longs because he was so inclined to take such a long view. As it stands, Toby's ideas would be difficult for the firm to leverage unless he changed his style.

Digging in more deeply, I explored Toby's capacity to be trained, his motivation to succeed, and his willingness to be part of a team to determine whether he was a viable candidate. What I found was interesting and challenging. Toby's profile shows that he is smart, a risk-taker, open to others' opinions, and flexible in his approach to things. He is extremely confident in himself. Because of this, it may appear as though he is not open and not listening but in fact he will attend to other people, particularly if he believes that they will be instructive in making him successful. He is focused, disciplined, and structured and has a balanced profile, displaying aggressive risk-taking as well as judgment and some cautiousness. However, he does not seem driven or motivated by reaching out to others, building relationships, and working for the benefit of others. From a coaching standpoint, Toby is trainable provided there is someone very strong-willed to coach and develop him. He would need someone who is strong enough to push back and refute his views as he is accustomed to being right (or at least to believing that he is right).

The Bottom Line

Of these three, Peter is by far the best candidate. The concerns regarding Dennis center on his interpersonal and leadership skills. While his current role as an analyst does not require strong leadership (necessarily), Dennis's lack of team orientation, partnership skills, and general interest in motivating and coaching others could limit his potential if he were to be considered for a portfolio manager role or to manage a team of analysts.

Toby is also a very smart guy, but at this point is a square peg for a round hole. In order for him to work out, he would have to change his investment style. Given that there is a large component of the role that is new to him (shorting), a question remains as to whether he will be too confident and too self-involved to seek out others for his own learning.

Hopefully, this example helps you to understand how to assimilate a variety of information on a number of candidates. Remember, traders are in a constant search for information that will provide a clue as to what will happen next, but even more important than the facts that they find are the ways in which those facts are digested. How are the details being perceived? How are investors reacting to the information? By considering these types of profiles, you can find evidence as to how each person will, generally speaking, react to various circumstances. By making considerations such as those discussed here, you can more readily determine a candidate's ability to succeed.

THE PERFECT CANDIDATE?

Is there really an ideal candidate, one who has all the "perfect" ingredients I have outlined in this chapter and throughout this book? Perhaps; but it should also be noted that some very successful people have only a few of these traits. The goal is to look for people who have as many of these characteristics as can be found. I am also advocating that other people develop some of their strengths along these lines. But, it is still important to recognize that some people have the *X* factor, and though they might not meet my idealized criteria, they might nevertheless be quite successful at trading. As with most of my books, this information is presented as a set of useful concepts from which to judge your own experience and what you need to do to improve your selection of PMs for your firm or improve your game if you are the PM yourself.

I think it is also important to understand that each person has his or her own style of trading and preparation. Clearly, when you look at people who have been successful over the years, you find a variety of profiles. Indeed, the more profiles you review, the more you realize the complexity of personalities and the value of digging deeper, exploring the potential fit of people you hire into your organization.

I recognize that there is not one single personality profile that is correlated with successful investing. Some people are strong in abstract reasoning and mathematics. Others have a gift for intuitively reading the movements of markets. Still others are skilled at managing teams of analysts because of their extroverted personality and their sensitivity to the levers that motivate people. The reason we assess personality is to find various combinations of talents that in our experience seem to increase the chances of success. While we are continually paying attention to the basic potential that each trader seems to have, at the end of the day, perseverance, experience, drive, and a variety of factors sometimes serve to compensate for apparent weaknesses in personality and natural talent. Passion, heart, and commitment are all very difficult variables to measure, but they are perhaps the most critical attributes for success.

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CHAPTER IN REVIEW

1. While no one single personality profile is correlated with successful investing, we can find various combinations of talents that seem to increase the chances of success by carefully:
   - Reviewing a person's psychological tests, personal history, life experiences, past professional experiences, and ways of dealing with risk, stress, life events, success, and failure
   - Conducting intense interviews and carefully considering reference checks
   - Evaluating how an individual handles research projects to assess the quality of his work, his diligence, his ability to think creatively, and his sense of urgency and thoroughness
   - Considering his capacity to function in terms of outsized performance targets, his ability to listen, and his ability to incorporate and process critical feedback about his performance by reviewing risk statistics
   - Examining his thought processes, his ability to troubleshoot, solve problems, assess complex situations, and identify the drivers influencing transformative events in companies
2. A few of the most important attributes of a successful trader are:
   - The ability to notice and separate emotional responses from the decision-making process
   - The ability to function with some degree of independence and autonomy while still following good risk management principles
   - The ability to stand outside oneself and one's concerns about images in order to function in terms of larger objectives
   - The ability to suppress ego and empower others to share ideas and best practices and accept coaching
3. Perseverance, experience, drive, and a variety of factors sometimes serve to compensate for apparent weaknesses in personality and natural talent.